RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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THE PICTURE: As far as the action of the Averages is concerned, this bull market remains very much intact. Last week saw new bull market highs on the part of the D-J Averages, 2594.23 for Industrials and 1082.85 for the Transports. Furthermore, my Primary Trend Index (PTI) continued to set record highs (see page 2 chart).

Can the stock market continue to climb? Sure it can, but read the section on "Price Action" in this Letter before you mortgage the house and double your blue-chip stock position. And I also suggest that you study the paragraph on valuation (at the end of this section) before you let your imagination run away with you.

Why? How? The explanations for the historic bull market climb are coming from all directions: "The Japanese are buying; they think the market is still cheap." "The public is skeptical, and bull markets don't topple over amid crowd skepticism." "The Elliott Wave count indicates Dow 3600 and that's where the Dow is headed come hell or high water." "There's an ocean of money sitting on the sidelines, and that money is getting very nervous as it watches this market climbing heavenward." "The secondary stocks have lagged badly, and bull markets don't end until the secondaries blow off."

Probably the most valid observation is the one that I've been making endlessly in the "Investment Position" box, and it is simply that "under Dow Theory this is still a bull market." It may be an overvalued and overextended bull market, but until the PTI starts tracing out a bear trend or until we get a Dow Theory bear signal, the safest procedure is to operate on the basis that the bull is still in command.

Since valuation is an integral part of the Dow Theory, however, I must admit that the weekly P/E and yield statistics hold me rather spellbound. For instance, this week the Dow was selling at 20.3 times earnings to yield a minuscule 2.68%. The D-J Transportation Average was selling at 43.7 (!) times earnings to yield an almost non-existent 1.35%. Finally, the broad S&P 400 Industrial Average was selling at 24.4 times earnings to yield a measly 2.32%. In comparison, rates on the long-term Treasury bonds this week rose to the 9% level, while the yield on the D-J 20 Bonds was 9.96%.

Perhaps because of the flagrant overvaluation, there seems to be an extraordinary amount of skepticism toward this bull market. The skepticism can best be seen in the daily ratios of S&P 500 puts to calls. On any one-day sell-off there is a surge of put buying. The buyer of puts is either speculating for the downside or hedging his portfolio against the downside. In either case, the expectation is for lower prices. So far, the market has been *stubbornly unwilling to oblige the bears.*

INVESTMENT POSITION: The one-horned bull is in the box. That missing horn tells us that we are witnessing a market that by any historical standard is overvalued. But hold it -- overvalued or not, it's still a recently reconfirmed bull market. And my Primary Trend Index (PTI) shows no hint of weakness yet.

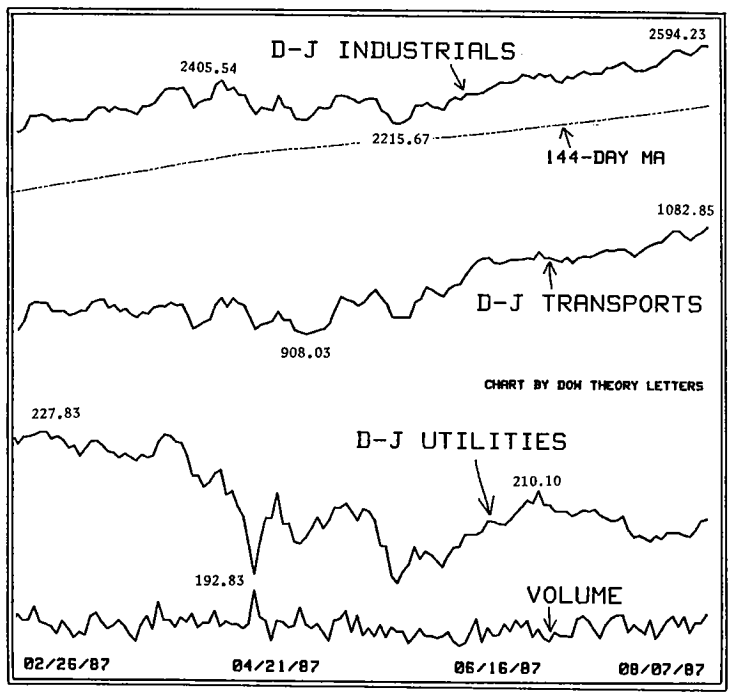
A lot of investors are frustrated with this bull market because their stocks haven't moved. The frustration dates back to March 1987 when the advance-decline ratio, which traces the advancing and declining tendencies in the majority of NYSE issues, topped out. (Two months prior to that the Utilities topped out.)

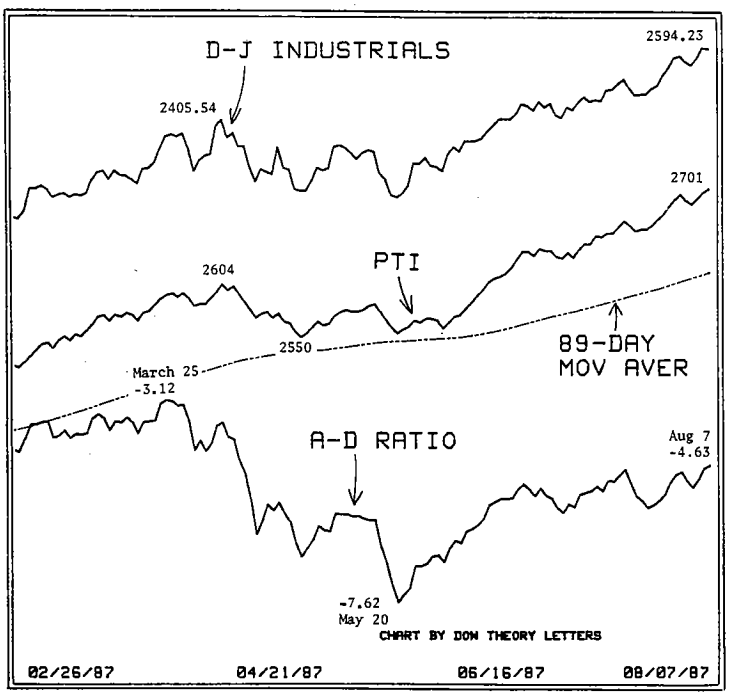
But readers of these Letters have not, I trust, been frustrated by the lag in secondary stocks. The reason: we haven't been in the secondary stocks, but rather we have been in the strongest blue-chip issues -- the ones that have been leading this bull market higher.

"When," I am asked, "are the secondary stocks going to take off and join the bull market?" That's a question neither I nor anyone else can answer. Did the March high in the A-D ratio mark the end of the advance for secondary stocks in this bull market? It's possible; I simply don't have the answer to that one (what we do know, however, is that foreign buying has been concentrated in the blue-chips and foreign buying may now be the chief force pushing this bull market higher).

In the meantime bonds have been testing the lower area of their 1987 range, but bearish sentiment toward bonds is now so acute that I am beginning to think that bonds are fishing for a bottom. I have an even stronger feeling that the much-maligned dollar has seen its low for 1987 (see dollar chart on page 6).

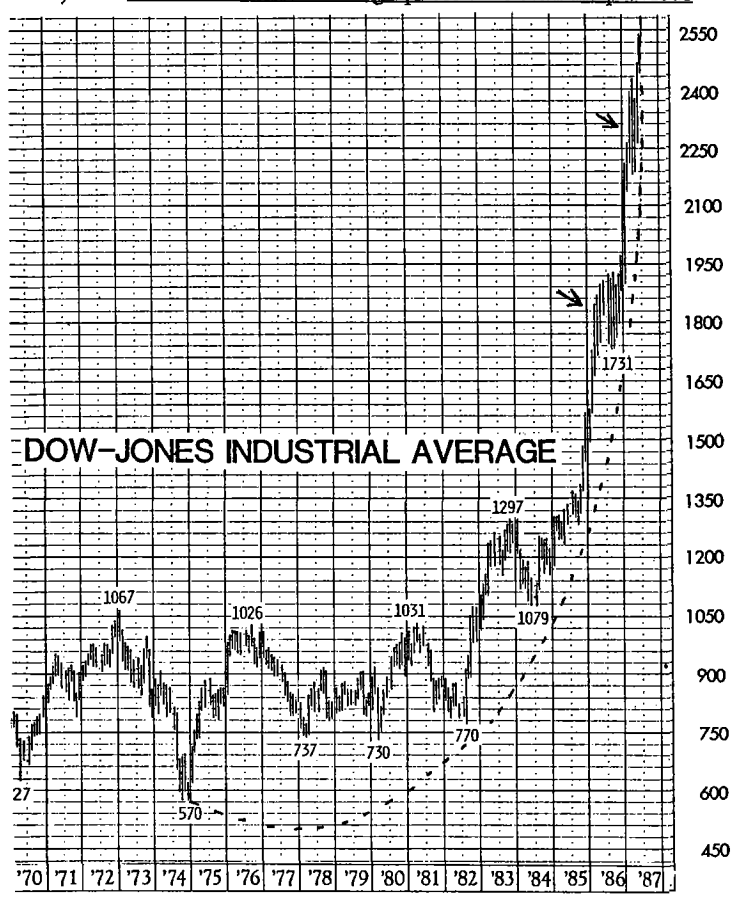
PRICE ACTION: Subscribers know that aside from the classical consideration of values, I take an intense interest in the price action of the market. For this reason, I want to update a chart that appeared in the March 25 Letter 961 (see page 2).





The chart (courtesy of M.C. Horsey) is a monthly arithmetic chart tracing the Dow action from 1970 to date. What we see here is the exponential rise in the Dow since 1974. The rise shown here is often called a parabolic curve. During an exponential rise, the angle of ascent increases geometrically until the price movement reaches an actual vertical rate of ascent. As you can see, the Dow is now in the vertical stage with the price action climbing literally straight up.

As a rule, once a parabolic rise reaches the vertical stage, major corrections are out. You simply get consolidations (arrows on the chart) with each consolidation taking up less time than the previous one. Finally, the price action streaks higher without so much as a pause. When the upward thrust of a parabola hits its final spear-point peak -- that's it. There is no correction and no more consolidations. The price action can be expected to come down as violently as it went up. We last saw this action, by the way, in the metals during 1980.



Question: Russell, if what you say about parabolic action is true, what should we do about it?

Answer: Assuming my analysis of the price action is correct in that the Dow is in a parabolic or exponential rise, then there is really no accurate way of timing the top. The top could come in a month or a year. But it is for this very reason (plus the extreme overvaluation in common stocks) that I have advocated a policy of taking profits as this market explodes upward.

In the last Letter I stated that you should now have about 65% of the amount of common stocks that you started out with in January 1986. I would continue the policy of gradual liquidation. This should not be too great a hardship since the yield on the 91-day T-bills has recently risen over 6% thereby providing better than twice the yield provided by either the Dow or the S&P 400 Industrials.

Question: Do you have any time frame or any Dow level at which you believe the bull market will end?

Answer: I'd be a liar or a crystal ball-gazer if I said that I did. The major averages have already risen to levels where they are providing the thinnest yields in stock market history. The rise in extent and duration has already broken all records. This market thrust is simply going to go to exhaustion. But you can also bet that the bull market will end at the point which will represent the "most inconvenient point" for the greatest number of shareholders.

One other observation: In almost everything I read it is said that following any correction in this market the averages should surge higher into the Dow 3500 to 4000 range. I don't subscribe to this view. As per the parabolic study, my guess is that this market is going to continue straight to whereever it's going -- and after that we can expect a primary bear market rather than a "refreshing step backward."

CLOSED-END FUNDS: Wall Street has suddenly discovered the wonders of closed-end funds, and 46 new closed funds have been introduced over the last year or so. Unlike a mutual (open-ended) fund, a closed-end fund is traded on the exchange just like any other common stock. But the closed-end fund is a holding company in that it holds shares (or bonds) in other companies.

The mutual fund always sells at net assets per share (minus the commission if it is a load fund). But the closed-end fund sells at whatever the market wants to price it at. Therefore, some closed-end funds will sell at a premium above net assets while others will sell at a discount below net assets.

One of the advantages for the managing company running a closed-end fund is that it never has to worry about redemption in a bear market. However if a bear market strikes, mutual funds normally get hit by redemptions or by switches out of the stock fund and into a money-market fund. But the managing company of a closed-end fund is immune from that kind of pressure. Sure, a closed-end fund will be hurt in a bear market, but only in price . On the other hand, theoretically a mutual fund can be subject to so many redemptions that it can be put out of business (the ultimate disaster to the management company).

My old friend, Marty Zwieg, knows this very well, and he was smart enough to start a closed-end fund known as the Zweig Fund (NYSE, ZF). The fund originally came out with a $300 million issue, which (the last time I heard) had increased to a market value of about $370 million.

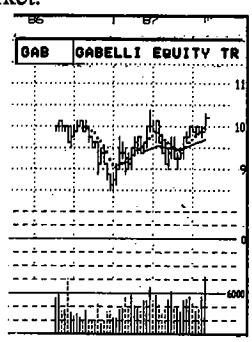
That's a good performance. But the Zweig Fund recently came out with an idea that I feel is a winner. They announced that they will pay out 10% of the funds net value each year in the form of dividend distributions at the rate of 2.5% quarterly. The last distribution of the year being greater if net investment income and net short-term realized capital gains exceed 10%.

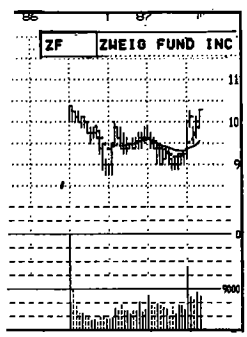
That's a good deal, to my mind. It's a particularly good deal because the 10% payout is based on net asset value, not on the market price of ZF. In other words, if ZF is selling at 10 (which is about where it is now) and the asset value of the fund is say 10.70 you are getting near 11% return based on your purchase price (plus probably a year-end distribution of profits).

Another feature I like about ZF is that they can sell short, hedge with options, and use other vehicles which can up their performance in bull markets and shield potential losses in a bear market. The final item I like with this fund is that Marty Zweig is an advisor to the fund, and Marty knows and understands both bull and bear markets. I feel that the vast majority of fund managers are far too performance minded (rather than safety minded) and are obsessed with their policy of staying "nearly 100 invested" regardless of what the market is doing.

The premium or discount on a closed-end fund is often a reflection of the prevailing sentiment toward the market. Thus when the public is "hot" for the market some funds will sell at a rare premium, but the usual is for a closed-end fund to sell at a discount to its actual net assets.

Interestingly, two fairly new issues are now selling below their issue price even though they have performed rather well. Zweig Fund is selling at 10 (its issue price) although its assets are now 10.93 per share. Gabelli Fund is selling at 10 1/8 (its issue price was 10) although its net assets have increased to 12.14. Growth Stock Fund (issue price was 10) is selling for 8 3/4 while its assets are 10.08. The older Lehman Corp is now selling at a 10.2% discount to its net assets and Tri-Continental (the largest of the closed-end funds) is selling for a 5.9% discount. From all this it can be seen that the public is currently rather lukewarm toward this market.

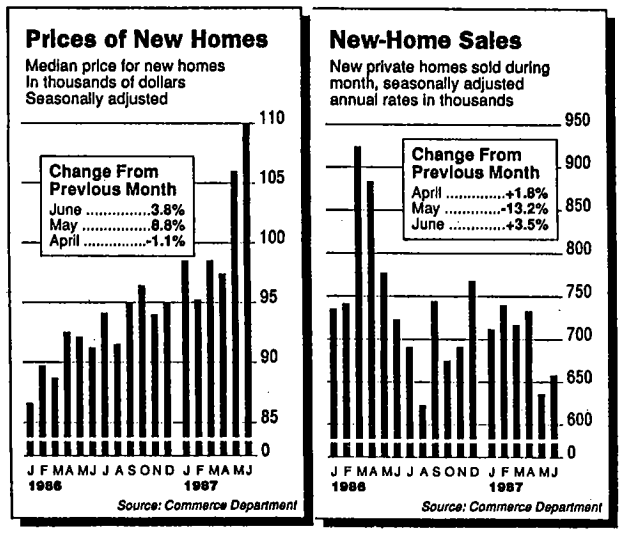




A HOUSE: I continue to receive many letters and questions about homes. "Should I own a house, or should I rent?" And there is no perfect answer. But here's what's happening. Conditions vary from area to area. In NYC, for instance, house prices are sky-high, but condo prices are softening (from previously sky-high levels). In favored areas (such as New England, much of Southern California, San Francisco) prices are high and going higher. In other parts of the nation (Oklahoma, Texas, Louisiana) prices are very soft and remain soft.

But the fact is that on average (nationally) prices continue to rise. This chart tells the story, and it's worth studying. The fact is that nationally, across the board, the price of homes has continued to rise. In fact, home prices have risen during every year of the 1980s despite anything you may have heard to the contrary.

So again the question: Is a home a good thing to buy? From an inflation standpoint, and assuming you buy in a favored area of the country the answer is yes. Since 1981 the average price of a new



house has risen exactly 50%, but can this continue? Sure it can. Will it continue? In my opinion, home prices will continue to rise as long as the primary trend of the stock market is bullish. And after that? After that I'd expect a substantial drop in home prices.

Next question: Is it economic to own a home? First, buying a home is not like buying stock in Sears or buying gold. You live in your home, you (hopefully) enjoy your home. There is a certain comfort and security in owning your own home. And it's as American as apple pie to own your own home ("a man's home is his castle" and all that). So there is the emotional plus in owning one's own home, but of course that will vary from individual to individual.

How economic is it to own a home? Well, a home is one of the few places where one can write off the interest on loans And, of course, with the new home loans you can write off the interest on whatever you borrow (up to a certain point) using your home as collateral (this is the latest interest write-off gimmick, but it's a good one, and it's one the Congress loves because Congressmen can use it too).

Now consider this: You own a home with a market value of $500,000. If you sell that home let's say you keep $450,000 after taxes. Put that money in tax-free bonds and you get $36,000 a year tax-free. All right, now you rent a nice home for say $1,800 a month so it now costs you $21,600 a year for housing. That leaves you with a fat $14,400 EXTRA to spend any way you wish.

So what I'm saying is that at today's home prices and at today's fat interest rates, owning a home is an expensive and uneconomic way to live. In fact, owning your own home only makes sense (1) if you love your home and love the idea of owning your own home or (2) if home prices continue to rise.

The hard-hearted alternative for the home owner is this: "I'll sell my house, save the money, and wait for the next bear market in housing. Then I'll buy another house, probably a better home than the one I have now and for less money. After all, this Wall Street bull market has been in force since 1974 and stocks are now offering the skimpiest yields in history. How much longer can the bull last? History suggests not much longer -- so I'll sell the old homestead and wait patiently."

The emotional response: I love the house, I'm happy as a clam living in it, my wife and kids love it, so why should I sell it just to pick up some bucks if and when the housing market caves in? Besides, the odds on more inflation are just as good as the odds for a bear market, so why play the guessing game with my life-style. No, I'll speculate with stocks, options, futures, or bonds but not with where I live. After all, a decent standard of living is what I'm working for -- so why lower my standard of living just to speculate on the next economic disaster -- which may never come.

So I've presented three views: the emotional view, the common sense view and the hard-headed and hard-hearted view of home

owning (or non-owning). Oh yes, I put my own home up for sale about 18 months ago. I could have sold it for a fat price. Then we looked around to see what else we could move into after we had sold the house. We ended up taking the house off the market in a week. Why? Because we couldn't find anything else we liked even half as well unless we paid considerably more than we would have received had we sold our present house.

What would make sense economically, is to sell the house here in La Jolla and then buy a comparable house in New Orleans or Houston for half the price and pocket the rest. The only thing is that I like it here in La Jolla despite the costs and despite the outrageous California taxes. So in the end, as they say, "each man has to kill his own snakes."

Question: One of your charts shows new home sales dropping off. The other chart shows the price of a new home spurting higher. How can price rise when sales are dropping off?

Answer: Sales are dropping off in the medium to lower price houses, but expensive (over $500,000) homes are still rising in price and selling well. Thus the average price of a home is being influenced strongly by the high-price market. The bigger the drop-off in low-end home sales, the higher the median price.

NOTES & QUOTES: What did I learn from the Iran-Contra hearings? I learned (although I already knew it) that too many of our government "leaders" are whimps. I'm talking about Secretary Shultz and Secretary Weinberger. But Abe Rosenthal of the New York Times said it best in his August 4 column entitled, "They Should Have Quit." Writes Abe: "Why did not Secretary Shultz or Secretary Weinberger resign and speak openly to all Americans and not just the President? Certainly the idea of resignation was not foreign to Shultz. He testified he had offered to resign no less than three times. ... Staying on the team -- was that the point? Shultz, by offering a resignation three times, cannot really make that argument. And certainly the thought must have crossed Weinberger's mind that if he believed selling arms to Iran was against the military interests of the US and could endanger Americans, he ought to pick himself out of his chair and say goodbye in a loud voice."

No, Abe, we have a government of whimps, be it selling arms to Iran or balancing the federal budget. Something seems to happen to men when they go to Washington. Maybe it's just Lord Acton's rule, that "All power corrupts. ... "

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A year ago it took 240 Japanese yen to buy a dollar. Now it takes only 150. Thus, US assets remain on the bargain counter as far as the Japanese are concerned. The Japanese understand and like real estate. Bought by the Japanese recently were the Atlantic Richfield Tower in LA ($620 million), ABC headquarters in NYC ($175 mil), 666 Fifth Ave. in NYC ($500 mil), Exxon Building in NYC ($610 mil), Algonquin Hotel in NYC ($29 mil). The Japanese also like Hawaiian real estate. They now own 70% of the hotels on the Islands.

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Bankruptcy is becoming the "in" thing in the US. In 1981 there were 360,000 bankruptcy filings in the nation. In 1986 the figure jumped to 530,000. The 9th Judicial Circuit (which includes LA) was the leader in bankruptcy filings: Last year it redistributed $51 billion from debtors to creditors.

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In the suburbs surrounding NYC, home prices doubled between 1980 and 1986. But experts are trying to decide whether the peak has been hit. Throughout the New York suburban region, housing prices are slumping and the supply is rocketing. Prices are still so high that the average family can't buy a house and pay the carrying costs. In nearby Stamford, Conn. for instance, it took an average of 304 days in June 1985 to sell a house. In June 1987 it took an average of 817 days.

* *

The fastest growing and most profitable end of the car market is the luxury segment. And the Japanese are going after it. I never liked Honda's Acura, but the division has sold 100,000 cars and has proved a success. Now Toyota and Nissan are after the $30,000 range cars. Nissan in 1989 will come with a 4-door V8, one of the first by a Japanese company. Toyota is expected to introduce a luxury sedan later this year. Mitsubishi will bring out its Galanta Sigma in mid-1988; the car will cost upward of $20,000. Mercedes and BMW — watch out (both of these German makes, are, in my opinion, overpriced).

* *

Former Arizona governor Bruce Babbitt advocates something I've spoken of many times, a national sales tax. The worry, of course, is whether Congress would use the $40 to $60 billion which a sales tax would bring in to simply further boost spending. At any rate, Babbitt seems to want to lay it on the line. In a speech before the National Press Club he said, "We've been dancing around the truth, nickel-and-diming the deficit with proposals that don't scratch the surface of the problem. If we want to get the federal budget under control, we'll have to do it the old-fashioned way ... we'll have to cut spending and raise revenue."

By running deficit spending through the roof, Congress has pushed all the eventual pain off to the next generation. In a new show of cowardice, the Senate now prepares to push any nearby plan for deficit reduction off to the next President. Here's a clip from the July 31 New York Times. Read it and -- gag:

By JONATHAN FUERBRINGER
Special to The New York Times

WASHINGTON, July 30 — Senate Democratic and Republican leaders have endorsed a new proposal to amend the budget-balancing law that could put off major decisions on the deficit and tax increases until after the 1988 elections.

The proposal, which the Senate began debating this evening, could allow Congress and the White House to sidestep some spending cuts this year and next and make unnecessary much of the $19.3 billion in tax increases the Democrats have endorsed.

In addition, the proposal, incorporating a new mechanism for making automatic cuts in spending if necessary, would limit the deficit reduction required for the fiscal year 1989, which starts Oct. 1, 1988. That budget will be considered while the Presidential and Congressional election campaigns are being fought next year.

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Marriage: According to the American Dietetic Assoc., after her 13th wedding anniversary the average American married woman will have gained 23 pounds, while her husband will have piled on 18 pounds. Russell solution: When you're hungry -- reach for your mate instead of a plate.

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Because of overpopulation, the authorities in China have ruled that each family can have only one child. China's "one child only" rule is producing some strange results. China now has 337 million children under the age of 14. Eight out of every 10 first graders now come from single-child families. This has given rise to what the authorities are calling "millions of pampered, over-fed, spoiled brats." Chinese newspapers are constantly warning against the "4-2-1 syndrome" which is four grandparents, two parents and one pampered kid. In Beijings's parks and department stores it is reported that pudgy kids are taking over, the girls wearing fancy ribbons in their hair and the boys wearing the latest in sporty little sailor suits.

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Alan Greenspan, the new Fed chief, has his work cut out for him. With world-famous inflation-buster Volcker leaving the Fed, Greenspan (this is the Russell opinion) may have to prove that he is an equally strong anti-inflation Fed-head. Thus, Greenspan is probably watching the trend of gold carefully. The big question everyone is asking: If gold moves up and the dollar turns weak and inflation heats up, will Greenspan put on the money clamps, and in doing so will he take a chance on a pre-election recession? Personally, I believe Greenspan would tighten money rates if

inflation heats up. I think he would have to -- or face the immediate label of being a weak Fed chief, something he could not afford this early in his new term. But political cynics are of the opinion that if inflation heats up before the next election -- the Fed would have to hold its fire, at least until the election was over.

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In California and the Southwest, Corona beer has been a favorite item for years. The beer has a sort of bite, a malty bitter taste that I personally like. But suddenly Corona has become a favorite and it's the leading import in 23 of the 25 Western and Midwestern states (beating out Canadian imports). Corona's seven Mexican plants are now on double shifts and the company can't keep up with US demand. When it comes to the East, it'll be a favorite; the fact is that it's really good beer.

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Recently CBS and Dan Rather produced a stunning one-hour program on the freedom fighters in Afghanistan. There were amazing scenes of actual combat. In one episode the cameraman crouched down with the accompanying Afghanistan fighters while Russian tanks rolled by (at night) maybe 50 feet from the camera. I was struck by the fierceness and dedication of the Afghanistan fighers. I'm sure that by now the Russians are too.

What's the real meaning of the Russian war against Afghanistan? There are a lot of theories, but my theory is that the Russians want to depopulate Afghanistan, to erase the population, to make it a no-man's land between Russia and Islamic fundamentalism.

There are 50 million Islamic fundamentalists in Russia, and indeed this is one of the fastest growing population groups in Russia. I believe this group is scaring the devil out of the Russian leaders, and they want a depopulated Afghanistan as a buffer against Islam.

The Wall Street Journal (August 7) began a series of articles on Islam. Here are a few paragraphs that are worth studying (particularly in view of what's happening in Iran and in the Mideast): "At a time when Marxism is so debilitated it is being shored up by capitalism, when Christianity lacks much of the missionary fire that once drove it, when Maoism is all but entombed with its founder and when democracy sounds only a muted appeal to much of the world, Islamic fundamentalism stands out as the movement on the march. ... It is clear that religious ferment, often labeled Islamic fundamentalism, is welling up across the Moslem world, from Morocco to Indonesia and far south into black Africa. There are in all more than a billion followers of Islam. ... The fervor touches every Islamic nation from the radical regimes of Syria and Algeria to the convervative monarchies of Morocco and Saudi Arabia. ... As a result the leaders of every Islamic country but Iran, and especially those of the Middle East and North Africa, are more vulnerable today than ever before."

So Islamic fundamentalism is worth thinking about -- and pondering. It could well be (and probably is) the human tide of the future. But few people at this juncture realize it.

* *

The most popular action these days seems to be selling the market short or buying puts on the stock market and the bonds. A friend who is a very active commodities trader called me today to say that "I can't believe this market (i.e., the Dow) can climb a thousand points and people can stay so negative. I've never seen anything like it. Maybe we're at the stage where the market goes into a final blow-off, and it's easier to make money during the blow-off than it's been at any time since the bull market started."

I told him that he could well be right. There's no question but people are remaining negative on this market (probably because their general portfolio is not doing that well). And the market -- day after day it stalls, tests to see if it wants to decline, and then (when selling dries up) it goes higher.

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Growth Stock Guide (Box 6600, Rapid City, SD 57709) often offers wise insights to the market. In its latest mailing GSG had this to say about the market: "By now it should be clear to everyone that the stock market is extremely overvalued on a fundamental basis. The price/dividend ratio of the S&P is 36 to 1, the second highest level of this century. So, how can the stock market rise from here? It's a case of an excess amount of money looking for profits while paying no attention to historical value parameters. We believe this behavior suggests the existence of a mania. No one can predict with certainty how long a mania will last or how high the market will now climb, but we do know that most investment manias end badly."

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From our "It's Not Easy" Dept: Only 39 funds (out of several thousand) outperformed the Dow over the last five years.

GOLD, OIL, INFLATION: Markets may be tricky, they may be erratic, they may be confusing -- *but they aren't stupid.* Gold has been in a bull market ever since February 1985, even though few investors (until recently) have been able to dig up any "reasons" why a new gold bull market should be underway. Over the last few months, however, the disinflation theme has given way to the "new inflation" scenario, and this has served to fire up the precious metals bull market.

Bull markets usually start out slowly, amid much skepticism, and the gold bull market (which began in February 1985 at 284.25) is no exception. But this year gold has been rather immune to talk of deflation; instead it has turned increasingly sensitive to talk of inflation. Add to that gold's upward response to potential Mideast trouble, and even the staunchest gold-phobe now must concede that a bull market in the precious metals is in force.

The weekly ratio chart of gold (Friday closings) tells the story better than I can at this point. As you can see, gold has been walking up a rising trendline. The action so far has followed the pattern of (1) a spurt in gold, (2) correction and consolidation, (3) another spurt, and repeat. This kind of action keeps the gold bulls happy while it keeps the gold bears hoping.

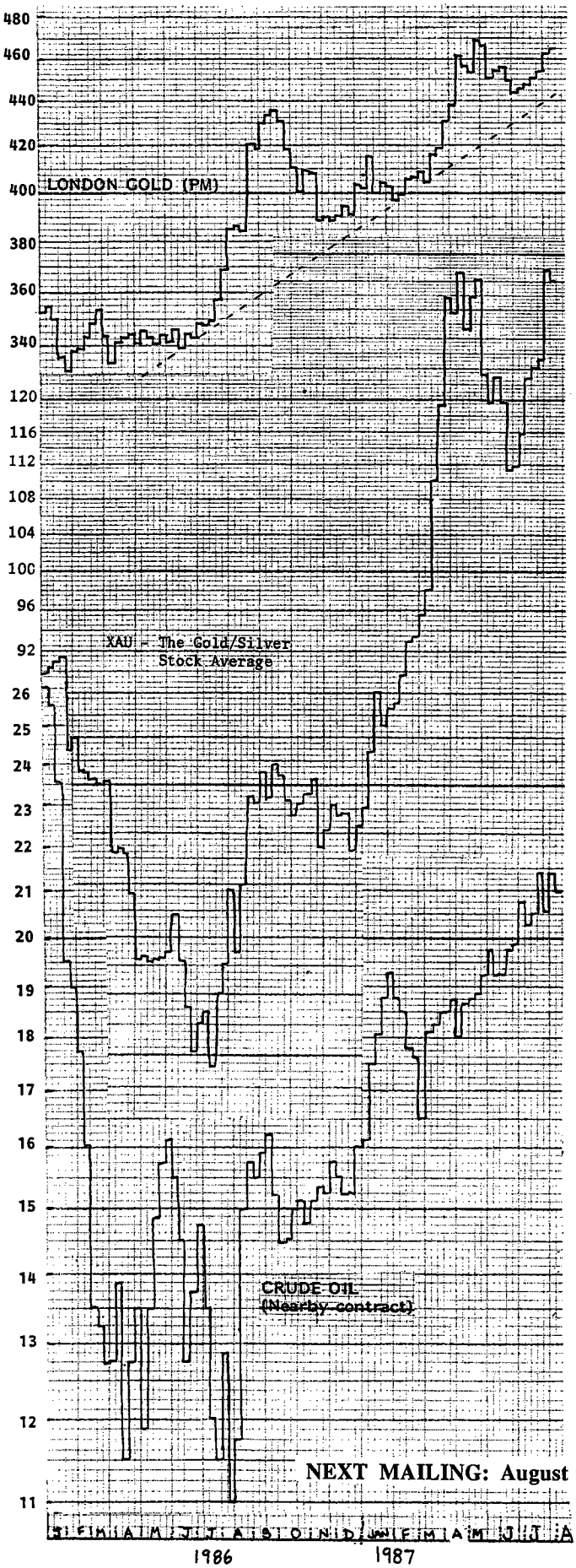
Among gold-philes the arguments and questions continue as to what has really been fueling the gold rise -- is it rising oil prices, exploding platinum prices, Japanese buying, the double US deficits (trade and budget) or is it simply a fear of inflation? The Russell guess: A bit of each of them. To paraphrase a brave old poem, "Ours not to reason why, ours just to continue to buy."

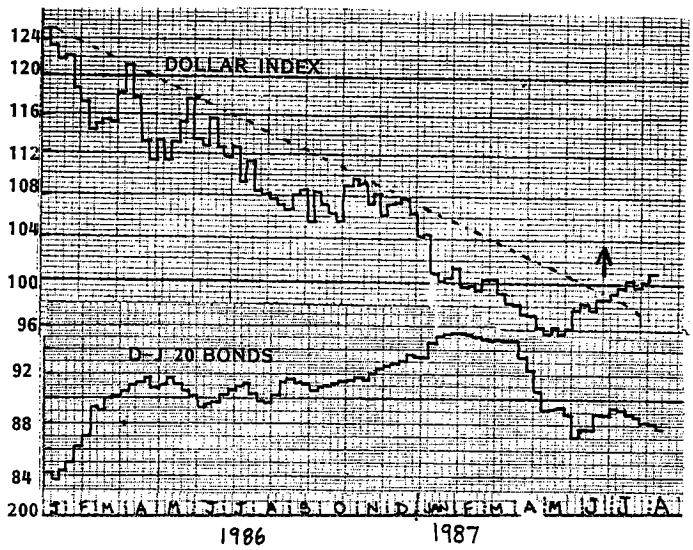
At this point, I believe (short-term) that the gold advance is overbought and overbelieved. Therefore, I feel that gold and precious metals should now simmer down and reconsolidate. A hint as to how strong the metals are will be seen in how much (or how little) they retreat during the consolidation period. It is well to remember that gold almost always *hits a low during the last quarter of each year.* With very few exceptions, then, an ideal spot to buy the precious metals has been at the fourth quarter low.

Nevertheless, I continue to advise a policy of buying an equal amount of gold (or platinum) coins each month. Before this decade is out, I believe my subscribers will see the wisdom of this policy. Following are a few reputable coin dealers: Blanchard, 800 535 7633; Ruffco 800 722 7833; Benham, 800 447 4653.

The gold/silver stock average (XAU), having collapsed from its January 1985 high, hit a low of 58 in July 1986. From there it's been "gangbusters" on the upside with XAU moving above 140 last week. That represents an incredible rise (even after the sharp April-June correction) of 150% in a little over a year. At this point, a rest is probably in order.

Yellow gold and "black gold" (crude oil) seem to be sisters of a sort. Crude oil, following its shocking 1985-86 collapse, hit a low of under 11 in April of 1986. Since then crude has doubled in price, and, of course, there's no greater spur to the precious metals than the inflationary spector of rising oil prices. The current Mideast situation is adding a spark of "excitement" to the oil picture, and after all, who knows what goes on in the minds of





millions of Iranians. What we do know is that oil was over $21 a barrel last week.

Perhaps the most interesting phenomenon of all (and I've been talking about this for a few months) is the major reversal in the dollar -- to the upside. Yes, the dollar is going up, *and for the first time gold has been rising with the dollar!* Up to now, traders could say that gold was simply going up against a weakening dollar. But more recently gold has been going up against the major foreign currencies. That's a big difference, and it's bullish (for gold) that *the metal has finally been climbing against all paper currencies.*

Finally we come to the bonds. Nobody expects bonds to go up in the face of rising gold and rising inflation expectations. So bonds have acted about as we would expect; they have headed down. The D-J 20 Bond Average dropped from just under 96 down to a July low of 86.86. Currently, everyone and his brother is bearish on bonds and the broad consensus is that "bonds are in a bear market and headed lower over the foreseeable future." That seems a bit pat to me, and I'm very interested to see whether that 86.86 can hold on the bonds. Another low point to watch is 86 16/32 on the September T-bond contract.

There, that's simple enough: oil, gold, gold shares, -- all going up together while the bonds are going down. What does it mean? On the face of it I would say that it means that investors have been forsaking disinflationary financial items (bonds, notes, etc.) in favor of oil, metals, and tangible items. Digging a little deeper it means that investors see good business and rising inflation ahead, and they are preparing for it.

LATE NOTES: Back in December 1974 with the Dow plunging to the 577 level, Wall Street was drowning in a sea of dire predictions. Many frightened analysts in late '74 held that "Dow 300 or 250" was just a matter of time. But the market, in its wisdom, decided that the worst had been seen. The bear market hit bottom in December '74 -- then turned up. At that time few people even dreamed that 13 years later Wall Street would be bubbling with enthusiasm and that the Dow would rise 700 points in the year 1987 alone (that was more, in fact, than the total point-value of the Dow in December 1974).

The market was exhausted on the downside in December 1974, and the big question today is "at what point will this market be exhausted on the upside?" This market still appears remarkably resistant to decline, and one of the few hints of exhaustion that I have at this time is yield. The Dow today is yielding 2.68%. That figure translates into high investor enthusiasm (and super-enthusiasm is one of the components of exhaustion). I can't think of another time in history when investors have been willing to pay 37.3 times dividends for the 30 stocks that make up the D-J Industrial Average.

NEXT MAILING: August 26